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SUBJECT: ESTONIAN RAILWAY DEAL HEADING INTO FINAL PHASE

REF: A) TALLINN 373 B) TALLINN 437 C) TALLINN 835

¶1. (U) Summary: On November 10, the Cabinet approved the GOE's re-purchase of Baltic Rail Services' (BRS) majority stake in Estonian Railways (ER). Although some Ministers and Members of Parliament have voiced public concerns over aspects of the deal, parliamentary approval is expected before the end of the year. End summary.

¶2. (U) On October 18, BRS and the Ministry of Economy agreed on the framework terms of a deal to sell BRS' 66% ownership in ER back to the GOE for EEK 2.35 billion (USD 192 million). In addition to the sale price, Min Econ agreed to pay BRS a dividend payment of EEK 150 million (USD 12.2 million). The deal included provisions for both sides to drop all outstanding legal claims (discussed Ref C). On Friday November 10th, the GOE cabinet approved the repurchase agreement. However, two cabinet members have subsequently spoken out against the agreement. Minister of Justice Rein Lang has stated that he thinks the agreement's requirement that the parties drop all legal claims may violate Estonia's Law of Obligations Act. This law stipulates that sellers must give a three-year guarantee on the goods they are selling. Finance Minister Aivar Soerd has expressed his concern that the agreed upon price is too high.

¶3. (U) The Estonian parliament now must approve both the agreement itself and the funding for the purchase. This will have to be done within the framework of a supplementary budget for 2006. Heido Vitsur, an advisor to Economy Minister Edgar Savisaar told us he is hopeful that the parliament will pass the necessary budget measure before the end of the year. The deal currently rests with the parliament's Economic Committee, whose chairman Mart Opmann has expressed his own reservations about the price, and has invited Savisaar and Soerd to explain the deal on Monday November 20. The full Parliament is scheduled to discuss it on November 22.

¶4. (SBU) Senior ER officials continue to stress to us that the transaction must be finalized by the end of the year or it will lose the support of BRS's management and shareholders. Christopher Aadnesen, Managing Director of ER told us that while he does not think any of the major parties in the GOE coalition oppose the deal, the longer it takes to finalize it, the more incentive BRS has to simply wait for resolution of the arbitration cases.

¶5. (SBU) Comment: The saga of the GOE's repurchase of the railway has been protracted and at times rancorous, to be sure. With Parliamentary elections coming in March 2007, some politicking is understandable, but momentum still seems to favor approval of the deal. End Comment.

